

ILEC affiliates provide local service. Nor does it address the regulatory consequence of the ILEC and its affiliate sharing brand names or other valuable resources. 41/ Accordingly, there is absolutely no basis for the contention of some ILECs that our Petition constitutes a late-filed request for reconsideration of the *Non-Accounting Safeguards Order*. 42/

Several ILECs contend that existing statutory and regulatory provisions are sufficient to ensure against anti-competitive ILEC conduct through “CLEC” affiliates, 43/ citing the Commission’s analysis in deciding that BOC Section 272 affiliates should be permitted to provide local service. 44/ Correspondingly, some ILECs suggest that Section 251(h) and the declaratory ruling requested by petitioners would somehow prevent the ILECs’ “CLEC” affiliates from providing local exchange service, 45/ or would limit the types of efficiency and quality-enhancing relationships that could evolve between ILECs and their affiliates. 46/ Neither the instant petition nor Section 251, however, would have any such effect. To reiterate, our Petition does not address *whether* an ILEC affiliate may offer local service, but what regulatory treatment should apply when it

41/ Ameritech admits this point. Ameritech at 19-20.

42/ *E.g.*, GTE at 4, 10-12; Ameritech at 2, 5, 6-7, 19, 20; BellSouth at 2-6.

43/ Bell Atlantic at 3-4; BellSouth at 3; GTE at 19-21; SNET at 9; SBC at 12.

44/ *Non-Accounting Safeguards Order*, 11 FCC Rcd at 22057-58, ¶ 315.

45/ Ameritech at 18; SBC at 3, 10, 11; SNET at 12; *see also* GTE at 3.

46/ USTA at 4; GTE at 3; SNET at 13.

does so. The Petition simply asks the Commission to ensure that, unless the presumption is rebutted, ILECs' "CLEC" affiliates will be governed by the same pro-competitive obligations that already apply -- per mandate of the Act -- to the ILECs. This would in no way prevent the "CLEC" affiliates from providing local exchange service or limit legitimate "efficiency" and "quality-enhancing" relationships that could develop between the ILEC and its "CLEC" affiliate, other than those relationships that would allow anti-competitive behavior and contravene the requirements of Section 251(c). 47/

2. The *Regulatory Treatment Order* Supports the Classification of ILEC "CLEC" Affiliates as Dominant.

As made clear in our Petition, 48/ the Commission's conclusions in the *Regulatory Treatment Order* apply only to ILEC affiliates' provision of in-region interstate long-distance service. 49/ Those conclusions have no relevance

47/ One ILEC also makes much of the Commission's findings that a BOC Section 272 affiliate may share services (other than operating, installation, and maintenance services), may jointly own property (other than transmission and switching facilities and the land and buildings on which those facilities are located), and may share brand names. Bell Atlantic at 4. Again, however, neither the declaratory ruling nor the proposed rule requested here would prohibit such sharing. They would simply require an affiliate that engaged in such sharing to be subject to the pro-competitive obligations imposed on ILECs under Section 251(c).

48/ Petition at 12-13.

49/ *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area; Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd 15756 (1997) ("*Regulatory Treatment Order*"). That decision also did not address the regulatory treatment of bundled, "full-service" offerings that include both local and long-distance service.

whatsoever to the treatment of "CLEC" affiliates in their provision of in-region local exchange and other interstate services, such as interstate access. Specifically, the conclusions reached in the *Regulatory Treatment Order* relied entirely on competitive protections applicable only in the long distance context, namely: the safeguards in Section 272 or the *Fifth Report and Order* in the Competitive Carrier Proceeding (requiring separate subsidiaries for local and long-distance service and arms'-length transactions between such affiliates); the price cap rules governing the access services that local ILECs provide to affiliated and non-affiliated long distance carriers; and the existence of large, well established long distance competitors each with ubiquitous or near ubiquitous networks and substantial excess network capacity. 50/

The analysis set forth in the *Regulatory Treatment Order*, however, amply supports the classification of ILEC "CLEC" affiliates as dominant in their provision of local exchange services. According to the *Regulatory Treatment Order* BOC and other ILEC affiliates should be classified as dominant carriers in the provision of in-region, local exchange services if a BOC or ILEC can use its market power in the local exchange or exchange access markets to enable its "CLEC" affiliate profitably to raise and sustain prices of in-region, local exchange services significantly above competitive levels by restricting the affiliate's output of those services. 51/ In determining whether a firm possesses market power, the

50/ *Regulatory Treatment Order*, 12 FCC Rcd at 15811, 15815-19, 15849-50, 15853-54, ¶¶ 97, 104-07, 162, 163, 169.

51/ *Id.* at 15802, 15804, ¶¶ 82, 85.

Commission focuses “on certain well-established market features, including market share; supply and demand substitutability; the cost structure, size or resources of the firm; and control of bottleneck facilities.” 52/ When applied in the local exchange context, this analysis 53/ demonstrates without question that ILECs and their “CLEC” affiliates would have the market power necessary to raise the price of local exchange service by restricting their output of local exchange service, and thus that these “CLEC” affiliates should be classified as dominant in their provision of local exchange services within the ILECs’ service territories.

3. Designation of ILEC “CLEC” Affiliates as “Comparable Carriers” Under Section 251(h)(2) Is Consistent With the *Guam NPRM*.

Several ILECs deceptively cite the *Guam NPRM* 54/ in support of an argument that treatment of ILEC *alter ego* “CLECs” as “comparable carriers” would be inconsistent with the Commission’s established interpretation of Section 251(h)(2). 55/ As an initial matter, the analysis in that Notice is only tentative, not

52/ *Id.* at 15809, ¶ 93.

53/ *See id.* at 15810-12, 15815-19, 15847-50, ¶¶ 96, 97, 103-07, 156-63.

54/ *Guam Public Utilities Commission Petition for Declaratory Ruling Concerning Sections 3(37) and 251(h) of the Communications Act, Treatment of the Guam telephone Authority and Similarly Situated Carriers as Incumbent Local Exchange Carriers Under Section 251(h)(2) of the Communications Act, Declaratory Ruling and Notice of Proposed Rulemaking*, 12 FCC Rcd 6925 (1997) (“*Guam NPRM*”).

55/ SBC at 9, SNET at 11, Ameritech at 21-22.

final. 56/ The question of whether the class of carriers under discussion in this proceeding meets the statutory criteria as “comparable carriers” is not affected by the issue of whether the Guam Telecommunications Authority and similar entities also meet those criteria (for different reasons given the different factual circumstances).

Moreover, the analysis in the *Guam NPRM* is not inconsistent with our alternative request that the Commission propose a rule establishing a rebuttable presumption that in-region “CLEC” affiliates of ILECs will be classified as “comparable” carriers under Section 251(h)(2). For example, the Commission recognized that the term “replace” in Section 251(h)(2)(B) “can mean to take the place of: *serve as a substitute for . . .*” 57/ This is consistent with our argument that ILEC-affiliated “CLECs,” as a practical matter, function as *alter egos* or substitutes for the ILEC when providing local service in the same geographic area, given the identity of their economic interests and the likelihood that consumers would perceive them (accurately) as interchangeable units of a single enterprise.

Finally, in the *Guam NPRM* the Commission indicated that “[a]n overly literal interpretation of [statutory terms] would . . . exalt form over substance” and run counter to Congressional intent. 58/ As with the Guam

56/ SBC fails even to indicate that the analysis it cites in the *Guam* case is part of a Notice of Proposed Rulemaking rather than a final order. SBC at 9.

57/ *Guam NPRM*, 12 FCC Rcd at 6942, ¶ 28 (citing *Webster’s Third New International Dictionary of the English Language Unabridged* (1993)).

58/ *Guam NPRM*, 12 FCC Rcd at 6946, ¶ 36.

Telephone Authority, failure to treat in-region ILEC-affiliated "CLECs" as "comparable carriers" under Section 251(h)(2) would be contrary to the market-opening, pro-competitive objectives of the 1996 Act. 59/

C. The ILECs' Attempt To Distinguish Between The ILEC Operating Company And The Holding Company Must Be Disregarded As Yet Another Disingenuous Shell Game.

The Commission should not allow itself to be hoodwinked by ILEC attempts to distinguish between an affiliate's receipt of resources from an ILEC operating company and an affiliate's receipt of resources from an ILEC holding company. 60/ A "CLEC" affiliate will be no more independent from the ILEC entity if it receives brand names, 61/ financial support, or other resources from the ILEC holding company than it will be if it receives the same resources from the ILEC operating company. Likewise, the ILEC operating company will have no less incentive or ability to discriminate in favor of the "CLEC" affiliate if resources are transferred from the holding company than it will if resources are transferred from the operating company itself. 62/ At bottom, the transfer remains a simple shift in

59/ See *id.* at 6940, 6943-6944, 6946-6948, ¶¶ 25, 32-33, 37, 40-41.

60/ See *Ameritech* at 3, 9-10, *BellSouth* at 9-10, *GTE* at 9.

61/ The notion that corporate names such as "Ameritech" or "BellSouth" refer to, or are considered by anyone to mean, anything other than the ILEC operating entities is ludicrous. In the case of the BOCs, the regional holding companies were *created* for the purpose of running the ILEC operating units after the AT&T divestiture.

62/ In cases with similarly far-reaching competitive implications, state commissions have refused to accord any significance to the asserted distinction between the ILEC operating entity and the holding company. See, e.g., *Joint Petition of New York Tel. Co., NYNEX Corp., and Bell Atlantic Corp. for a*

resources from one pocket of the ILEC entity to another, and no amount of ILEC shell-shifting will change this ultimate reality.

The Commission must not permit ILECs to avoid the critical market-opening requirements of the 1996 Act simply by placing artificial -- and transparent -- corporate veils between themselves and their statutory obligations. To do so would not only contravene the clear congressional intent behind Section 251, but also cheat both consumers and competitors of the competitive opportunities promised under the 1996 Act.

D. State Experiences Underscore the Need for Prompt Commission Action Under Section 251(h).

BellSouth attaches to its comments in this proceeding a misleading list of states purportedly approving the establishment of "CLEC" affiliates within their ILECs' service territories. 63/ Most fundamentally, this list underscores the urgency of the need for Commission action to clarify that (absent a factual showing to overcome a rebuttable presumption) such affiliates are subject to Section 251(c). BellSouth's list shows that ILECs are attempting to set up *alter ego* "CLEC" entities

*Declaratory Ruling That the Commission Lacks Jurisdiction to Investigate and Approve a Proposed Merger Between NYNEX and a Subsidiary of Bell Atlantic or, In the Alternative, For Approval of the Merger, Cases 96-0603 et al., Opinion No. 97-8, 1997 WL 314725, *14-*15 (N.Y. Pub. Serv. Comm'n May 30, 1997); Pacific Telesis Group, Application 96-04-038, Decision 97-03-067, 177 P.U.R. 4th 462 (Calif. Pub. Util. Comm'n Mar. 31, 1997).*

63/ BellSouth at Attachment A.

all around the country, and that this trend must be reviewed and checked -- *now*.

The 1996 Act puts that responsibility squarely in the hands of the FCC. 64/

That said, it should also be noted that BellSouth's list is disingenuous. The list in no way represents an endorsement of *alter ego* "CLECs" by the states. Rather, this list includes not only a state that actually has *rejected* the provision of service by an ILEC's "CLEC" affiliate within the ILEC's service territory (Michigan), but also a state that has not yet finished its deliberations (Florida); states that made their decisions without ever reaching the issue of applicable federal law; states that considered only a narrow set of criteria and applied no other legal or competitive analyses in making their determinations; and states that approved "CLEC" affiliate applications only after imposing conditions designed to protect against anticompetitive conduct.

Contrary to BellSouth's list, the Michigan Public Service Commission has rejected the application of ACI, a "CLEC" affiliate of Ameritech Michigan, to provide local service within the Ameritech Michigan service territory, until the FCC grants Ameritech Michigan authority to provide in-region interLATA service. 65/

64/ Section 251(h), by its explicit terms, contemplates that the FCC will play a leading role on this issue. *See also Iowa Util. Bd. v. FCC*, 120 F.3d 753, 794 n.10 (8th Cir. 1997), *petition for cert. granted*.

65/ *Ameritech Communications, Inc.*, Order Approving Application, Case No. U-11053 (Michigan Pub. Serv. Comm'n August 28, 1996) ("*Ameritech Communications, Inc.*") at 17 (granting ACI authority to provide basic local exchange service within the service area of GTE but denying ACI such authority within the service area of Ameritech Michigan until Ameritech Michigan is authorized by FCC to provide interLATA service). These considerations underscore

The Michigan Commission based this decision largely on testimony that Ameritech Michigan and its proposed "CLEC" affiliate, ACI, would "work together to manage the local exchange market through the creation of a de facto cartel;" that Ameritech Michigan and ACI could "effectively force existing Ameritech Michigan customers to migrate to ACI simply by adjusting their respective prices to target the desired customer segments;" and that "any benefit to consumers from ACI's entry into the marketplace is not only small in absolute terms, but also dwarfed in comparison to the scope and magnitude of the potential harm to customers and competitors." 66/ Similarly, the Texas Public Utility Commission has rejected the application of GTE's "CLEC" affiliate to provide local services within GTE's service territory in Texas. 67/ And Pacific Bell Communications, an affiliate of Pacific Bell, withdrew its application to provide local service in Pacific Bell's service area in light of a negative preliminary decision by an administrative law judge. 68/

why ACI would have to be subject to Section 251(c) even once it is allowed to provide local service.

66/ *Ameritech Communications, Inc.* at 12-13.

67/ *Application of GTE Communications Corporation for a Certificate of Operating Authority in SWBT, SPRINT/UNITED, and CENTEL Service Territories (Re: Docket No. 16495), Order, Docket No. 18146, SOAH Docket No. 473-96-1803 (Texas Pub. Util. Comm'n October 30, 1997) (granting GTE-CC authority to provide local telephone service, but excluding from GTE-CC's service area the service area of GTE-SW).*

68/ *Application of Pacific Bell Communications for a Certificate of Public Convenience and Necessity to Provide InterLATA, IntraLATA, and Local Exchange Telecommunications Services Within the State of California, Application 96-03-007, Proposed Decision of ALJ Walker at 20-21 (Cal. PUC May 6, 1997); withdrawn by Assigned Commission's Ruling (Oct. 15, 1997). But see Application of GTE Mobilnet of California, Inc. (U-4028-C), for a Certificate of Public Convenience and Necessity*

Florida, also contrary to BellSouth's list, has not "approved" BellSouth BSE's application for a certificate to serve as a CLEC in BellSouth's service area. Although BellSouth notes on its list that protests had been filed with respect to this application, BellSouth neglects to mention that the only action the Florida Public Service Commission has taken with respect to this application has been to issue a *preliminary* Notice of Proposed Agency Action concerning the application, and that the protests filed in response to that Notice triggered the initiation of a formal proceeding, which currently is pending before the Florida Commission. 69/

Other state decisions regarding the regulatory status of ILEC "CLEC" affiliates are likewise of little guidance in that they either do not reach the issue of applicable federal law or do not consider factors other than the affiliate's financial, technical, and/or managerial qualifications, and in some cases, a limited public interest determination. States such as Tennessee, Missouri, New Jersey, and Washington have approved the establishment of ILEC "CLEC" affiliates within the ILEC's service territory based solely on their consideration of the affiliate's financial, technical, and/or managerial qualifications, as well as some limited regulatory compliance determinations, but without any other legal or competitive

to Provide InterLATA and IntraLATA Telecommunications Services Within the State of California, Opinion, Application No. 95-09-015, Decision No. 96-02-040 (California Pub. Util. Comm'n February 23, 1996) (granting in-region certificate to GTE wireless affiliate).

69/ *Application for Certificate to Provide Alternative Local Exchange Telecommunications service by BellSouth BSE, Inc.*, Prehearing Order, Docket No. 971056-TX, Order No. PSC-98-0577-PHO-TX (Florida Pub. Serv. Comm'n April 24, 1998), at 2.

analyses concerning the affiliate's relationship with the ILEC. 70/ Other states have applied even more narrow criteria. Virginia, for example, limited its consideration of a proposed "CLEC" affiliate to a determination of whether the proposed "CLEC" was in compliance with the Virginia Corporation Commission's Rules for Local Telephone Competition. 71/

Other states that have approved "CLEC" affiliate applications have done so only after imposing conditions designed to protect against anticompetitive conduct. For example, the Nevada Public Service Commission granted a Sprint "CLEC" affiliate authority to provide local exchange service in the Sprint ILEC's service territory only after imposing a number of safeguards on the ILEC and its "CLEC" affiliate. 72/ These safeguards included requirements that the ILEC and

70/ *Sprint Metropolitan Networks, Inc.*, Notice of Proposed Agency Action, Docket No. 951310-TX, Order No. PSC-95-1602-FOF-TX (Florida Pub. Serv. Comm'n December 27, 1995) (no public interest analysis); *GTE Card Services Incorporated d/b/a GTE Long Distance Incorporated*, Notice of Proposed Agency Action, Docket No. 961371-TX (Florida Pub. Serv. Comm'n February 24, 1997) (no public interest analysis); *Sprint Communications Company L.P.*, Order, Docket No. 96-01153 (Tennessee Regulatory Authority October 3, 1996) (no public interest analysis); *Sprint Communications Company L.P.*, Report and Order, Case No. TA-96-424 (Missouri Pub. Serv. Comm'n February 28, 1997); *Sprint Communications Company, L.P.*, Order, Docket No. TE96060479 (New Jersey Board of Pub. Util. July 17, 1996); *Petition of Sprint Communications Company L.P. for an Order Granting Amendment to Registration to Provide Local Exchange Services and Authorizing Provision of Intraexchange Telecommunications Services*, Order, Docket No. UT-971048 (Washington Util. and Transport. Comm'n July 9, 1997) (no public interest analysis).

71/ *Sprint Communications Company of Virginia, Inc.*, Order, Case No. PUC960086 (Virginia State Corp. Comm'n November 8, 1996).

72/ *Application of Sprint Communications Company, L.P. for Authority to Operate as a Competitive Provider of Intraexchange Telecommunications Services*

its affiliate maintain separate books, records, and accounts; share no officers, directors, or other employees; and conduct all transactions on an arm's-length basis. 73/ The Nevada Commission also prohibited the "CLEC" affiliate from obtaining credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the ILEC; required regular independent audits; and required the affiliate to include disclosures clearly distinguishing between the ILEC and the affiliate in "any and all advertising or promotions disseminated" in the ILEC's service territory, in order "to distinguish between services provided by it and [the ILEC] to minimize confusion on the part of customers." 74/

We are aware of only one state commission that has fully considered this issue on the merits and reached an opposite result -- the Connecticut Department of Public Utility Control's decision concluding that SNET's in-region

Within the State of Nevada, Modified Final Order, Docket No. 96-9014 (Pub. Serv. Comm'n of Nevada November. 17, 1997), at 7.

73/ *Id.* at 7.

74/ *Id.* See also *Petition filed by Central Telephone Company-Nevada for an Order Authorizing it to Change its Name from Central Telephone Company to Sprint of Nevada*, *Petition Filed by Central Telephone Company for an Order Authorizing Relief from Restrictions Adopted in Docket Nos. 92-9025, 91-7026 and 91-5054*, Stipulation, Docket Nos. 97-7056, 97-8006 (Nevada Pub. Util. Comm'n Staff February 13, 1998) (imposing conditions on the affiliate's ability to engage in joint marketing); *BellSouth BSE, Inc.'s Application for Certificate of Authority to Provide Local Exchange Telephone Service*, Interim Certificate of Authority to Provide Competitive Local Exchange Telecommunications Services, Docket No. 8043-U, at 3, 5 (Georgia Pub. Serv. Comm'n March 5, 1998) (imposing similar conditions). The Petitioners do not necessarily concede that such safeguards, even if complied with, would be sufficient to rebut the rebuttable presumption that the "CLEC" affiliate is a "successor" or "assign" of the ILEC.

"CLEC" retail affiliate, SNET America, Inc. ("SAI"), is not a "successor" or "assign" under Section 251(h). 75/ That decision, taken in the context of an overall restructure of SNET's retail and network operations, is now on appeal before both state and federal courts. We believe that Connecticut reached the wrong result, and should not be followed, for the reasons discussed throughout our Petition and these reply comments.

While the states ideally would play a substantial role in addressing the issues surrounding the ILECs' "CLEC" affiliates, it is clear that many have had -- and will continue to have -- difficulty finding the authority under state law to address the legal, competitive, and other policy implications of the relationship between ILECs and their "CLEC" affiliates. Accordingly, prompt action by the Commission to establish, on the federal level, the rebuttable presumption here requested is both appropriate and necessary. Moreover, even after the Commission establishes the rebuttable presumption detailed herein, we anticipate that the state commissions would be closely involved in regulating ILECs' "CLEC" affiliates and closely scrutinizing their transactions and other relationships with the ILECs themselves.

75/ *DPUC Investigation of the Southern New England Telephone Company Affiliate Matters Associated with the Implementation of Public Act 94-83*, Decision, Docket No. 94-10-05 (Connecticut Dept. of Pub. Util. Control June 25, 1997), at 59, *appeals pending*; see also *Application of SNET America, Inc. for a Certificate of Public Convenience and Necessity*, Decision, Docket No. 97-03-17 (Connecticut Dept. Pub. Util. Control June 25, 1997) (granting Certificate based on SAI's financial resources, managerial ability, and technical competency).

CONCLUSION

For the reasons set forth above and in our original Petition, the Commission should issue a declaratory ruling establishing a rebuttable presumption that, to the extent that an affiliate of an ILEC provides wireline local exchange or exchange access service within the ILEC's service area using brand names or other resources derived from the ILEC, that affiliate itself will be treated as a "successor" or "assign" of the ILEC under Section 251(h)(1), and as a dominant carrier. In the alternative, the Commission should propose a rule establishing a rebuttable presumption that such ILEC affiliates be classified as "comparable carrier" under Section 251(h)(2). In both cases, ILEC-affiliated carriers that cannot rebut the presumption should be subject to the interconnection obligations of ILECs under Section 251(c) of the Act.

Respectfully submitted,

COMPETITIVE TELECOMMUNICATIONS
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Dated: June 1, 1998

ATTACHMENT A

EXHIBIT 5

Income Statement

BellSouth BSE, Inc.

PRELIMINARY

(All numbers in 000s)

		1997	1998	1999	2000	2001	2002
Customers (000s)							
Number of Customers							
Mass Market		-	325	954	1,154	1,187	1,242
Business		-	13	30	66	82	118
Number of Access Lines							
Mass Market		-	385	1,134	1,373	1,424	1,477
Business		-	128	353	638	884	1,148
(0000s)							
Revenue							
Mass Market		-	183,188	1,003,303	1,519,812	1,758,033	1,820,758
	Local/Intrastate		46,577	308,203	476,889	581,058	612,773
	Long Distance		11,309	67,879	83,753	102,867	112,366
			36,808	814,861	298,883	325,747	355,826
	Cellular		42,245	289,880	498,178	538,283	587,544
			548	3,756	5,915	6,879	7,618
	Internet		3,296	22,267	34,781	40,826	44,682
	Video		14,378	88,578	155,234	183,174	199,838
Business		-	182,241	862,522	1,472,363	2,162,330	2,881,812
	Local/Intrastate		92,207	583,243	873,541	1,280,200	1,747,082
	Long Distance		70,034	388,280	598,822	882,130	934,731
Total Revenue		-	316,400	1,865,825	2,991,874	3,911,363	4,602,569
Expense							
Mass Market							
Cost of Services							
Sold (COSS)		-	118,619	761,686	1,221,108	1,373,649	1,424,806
Sales, Service,							
General and Admin							
(SSG&A)		4,216	133,868	170,827	188,461	198,042	205,504
Business							
COSS		-	120,334	882,268	823,349	1,282,170	1,505,395
SSG&A		5,337	96,341	111,718	184,838	280,780	330,155
Common SSG&A		18,818	85,925	47,338	53,785	63,568	55,274
Total Expense		28,369	492,886	1,753,602	2,578,542	3,178,209	3,521,134
Gross Margin		(28,368)	(177,487)	202,323	413,432	733,154	1,081,434

CERTIFICATE OF SERVICE

I, David A. Maybee, Jr., hereby certify that on this 1st day of June, 1998, a copy of the Reply Comments of the Petitioners was served on the parties listed below by hand delivery or first class mail.



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